Ryland reviews state of the company at 1983 annual shareholder meeting

From the June 1983 Frontier News, pages 2 and 3.

175 Frontier Holdings shareholders — including many airline employees — gathered April 28 in Denver for the company's annual shareholder meeting.

Frontier News offers this summary of comments and answers to questions by Chairman Glen Ryland and other officers to those employees unable to attend.

Earnings

1982 was the 11th consecutive year of profitability for Frontier.

While our earnings of $17.2 million were certainly below our standards, our performance remained better than most of the airline industry.

The latest tally shows the industry in total lost a record $900 million in 1982, with Frontier one of seven major and national carriers to make a net profit.

We identified several negative trends starting in late 1981 that continued in 1982 — presenting Frontier with some of the most extraordinary challenges we've faced in a decade. So far, 1983 is continuing to put us to the test.

Traffic was good in the summer of 1982, as usual, although most of it was stimulated by the extremely low fares. After Labor Day, however, our traffic fell off a cliff, and the combination of decreased traffic and depressed passenger revenues resulted in a fourth quarter loss of $6 million — our first quarterly loss in a decade.

Traffic improved the first quarter of 1983, but at the severe expense of yield (the revenue per passenger mile). Price has clearly become the driving force in the marketplace, and Frontier made the strategic decision to match all competitive fares in early 1983, many of which were below actual costs. With planes full of discount passengers, our yield dropped 21 percent from the first quarter of 1982, and we recorded a first quarter net loss of $10.2 million.

Frontier's performance in the fourth quarter of 1982 and the first quarter of 1983 was not an overnight phenomenon. We anticipated the negative trends, and started early in 1982 taking corrective actions to enhance revenues and control our costs.

While the beneficial effect of all our actions will take some time to be felt, some encouraging signs are emerging.

Frontier initiated a five percent basic fare increase March 4, a move followed by our competition.

We streamlined our fares further and structured them on a pricing-by-distance formula April 15.

As a result of management actions, particularly in capacity control and fares, we are beginning to see some modest improvement in yield. Along with these positive pricing trends, we are also pleased to see a drop in fuel prices and some hints of an improving economy.

Cost control

While revenue enhancement is a high priority, we are also continuing to reduce costs.

As a part of a series of actions in 1982 to bring our costs in line with lower revenues, we furloughed seven percent of our work force in March 1982.

On Feb. 1, 1983, salaries of non-contract employees and management were cut by 10 percent. We hoped union-represented employees would recognize the need for such cost reductions even before their contracts were open and amendable. This did not occur. While negotiations are in progress with the unions, the salaries of non-contract employees (excluding officers) have been restored to their pre-Feb. 1 levels. We will continue to seek wage and work-rule concessions in negotiations with employees represented by the four unions whose contracts are up for negotiation in 1983.

We reached a tentative agreement with the union representing the pilots on May 19. Negotiations with two other groups are underway. So, the non-contract salaries will remain constant for the moment. Based on the outcome of negotiations, we will again evaluate non-contract salaries so all share equitably in the necessary sacrifices.

In another cost reduction move, we increased the efficiency of our ground operations at the Denver airport May 1 by more even distribution of the flight frequencies among our eight daily "banks" of arrivals and departures. We now have fewer airplanes on the ground at Denver at any given time of the day, although our total number of departures increased June 1 to 123. This reduces the required number of employees to handle the flights. This "de-peaking" action has required some furloughs of ground staff. At this time we are also reviewing recall of some flight personnel, so our employment level should remain at about 5,300.

Employees

A group of employees at the Denver station should be applauded for their innovative VFR (Volunteer Frontier Representative) program which came out of a quality circle group at the Denver station. A trial period began May 1.

Several hundred employees have volunteered their time to serve as inflight customer service representatives. The purpose of the program is to convert return passengers to Frontier and hopefully differentiate in the customer's mind Frontier's service from other airlines.

This kind of spirit should be applauded and endorsed.

Marketing

A major step in our revenue enhancement program is the development of a new Denver marketing strategy to improve our local market share and improve the declining yield trend. Short-haul trips traditionally have a higher yield than long-haul trips.

Initiated this January, this strategy consists of a shift in emphasis from primarily long-haul, through-Denver traffic, to a balance of long- and short-haul. We substantially increased our advertising and sales promotion budget, simplified our pricing, and took steps to substantially improve our display in travel agency automation systems.

To capture more feed traffic for Frontier from surrounding communities, we have established transportation networks on the ground and in the air to bring passengers to Denver to connect to our flights. We began a joint marketing program March 1 with two commuter airlines — Air Midwest and Pioneer — to provide passengers from 23 regional cities more convenient connections to our flights to and from Denver. Free ground transportation started May 1 between Denver and Boulder, and Fort Collins, for our passengers, scheduled to match Frontier departure and arrival schedules.

Seat selection

A major advance in our 1983 marketing offensive is our novel link to the American Airlines Sabre computer system — enabling more than 7,000 travel agents to sell Frontier with advance seat selection and pre-issuance of boarding passes to passengers. This new service will be in effect in mid-September, and should move us to the forefront of airline automation technology.

Frequent Flyer

Our new frequent flyer program with American Airlines is a major thrust in the marketplace. Passengers may accumulate travel credits for discounts and free trips to any destination on both the Frontier and American route systems — including 150 points in the U.S. and 15 other countries. The unique attraction of the combined destination incentives — and the joint marketing resources of the two airlines — are expected to give us a key advantage.

Economy

The airline industry is particularly sensitive to the cyclical ups and downs of the economy. The recession clearly caught up with our region last year, producing a severe negative effect on our traffic and revenues.

Competition

While we were starting to feel the effects of the recession in 1982, our competitors began to take actions that had a significant impact on the way we do business.

Some airlines in severe financial difficulty began pricing their products without regard for profitability, forcing the healthier airlines to match the uneconomical low fares.

Particularly in Denver, the competitive environment for Frontier has intensified. Prior to deregulation, in 1978, Frontier had competition on only 30 percent of our Denver-originating routes. Going into 1983, this had grown to 60 percent. Roughly half this competitive growth resulted from Frontier expansion. The remainder represented incursions by other airlines into our established route system.

Air traffic control

Constraints in the air traffic control system — resulting from the 1981 strike by air traffic controllers — continued into 1982 and 1983. These have impaired our ability to optimize the strengths of our Denver connecting hub. As the situation loosened up some during 1982, other carriers added extra flights, and entered our markets.

Before the strike, in June 1981, Frontier had 132 daily departures from Denver. United had 120 and Continental had 100.

After the strike, and during the PATCO-induced constraints, we reduced our operations as required, as did United and Continental. In May and June of 1982 the FAA (Federal Aviation Administration) allowed airlines to purchase arrival 'slots" from other airlines. United quickly purchased 24 slots — at high prices — and added flights while we were held at the status quo. United is now up to 144 daily departures, with Continental at 91, and Frontier at 123.

Second-tier airline

We have not made a decision in this regard, but it is something we are studying.

Along with the incursions we have experienced from other airlines — including six new airlines that have entered the Denver market since deregulation — we now face Southwest Airlines for the first time.

Southwest — a discount, low-cost airline — is offering six daily flights from Denver to Albuquerque, with continuing service to El Paso and Phoenix.

This creates a giant challenge for us. We do not intend to give up our markets. We are not going to back away from the markets we now serve. But Southwest came in with fares far below the fares we had been receiving, which were not great from the perspective of yield. We chose to match Southwest's introductory fares.

We can either bow out and admit we don't want to sell our seats below cost, sell them below cost and become a weaker airline, or find a way to cut costs so we can compete in those types of markets. We are studying our limited alternatives and we'll have more to say when we make some decisions. But no decisions have been made at this time.

Routes

Continuing to strengthen our hub-and-spoke route system, we added seven new cities in 1982 and have added four in 1983.

At the same time we have terminated service to 11 smaller communities that were clearly unprofitable. On May 1 we seasonally suspended service to three cities in Mexico, and we are evaluating the restoration of that service next winter, depending on improvements in yields, the economy, and our service pattern to the cities.

Fleet

During 1982 we acquired four Boeing 737s and five McDonnell Douglas Super 80s, bringing our fleet total at year-end to 49 737s and five Super 80s.

Consistent with our long-range planning, we added two more 737s to our fleet this spring.

Because we didn't require all the capacity we had coming on, we leased two 737s to another carrier, which we'll get back in September, as a short-term efficiency move.

When we bought the first three Super 80s last May it was not clear to us that they would make money. For one thing, their unit cost per airplane mile is dramatically higher than the 737, and we didn't know if we had the dense markets to use the additional seating.

We deployed the Super 80 in high density markets, such as Denver-Orange County. Since it was inaugurated, the Super 80 in any given month on any route has produced load factor percentages from four to 10 points higher than the 737. As a direct result, we considered the "experiment" a success, and bought two more in December.

Three seats are being added in place of the forward coat closet on the 29 Boeing 737s with enclosed overhead bins. This is not being done on the 22 Boeings with open overhead racks. By mid-summer, all 737s will receive an additional seat in row 18 on the left side — currently a two-seat row. As a result, we'll have 29 737s with 110 seats and 22 with 107.

Frontier Holdings

While the airline is clearly the primary subsidiary of Frontier Holdings, the other subsidiaries have been active

Frontier Services acquired the International Aviation and Travel Academy in Dallas (a profitable subsidiary of Braniff), Colorado Aero Tech in Broomfield, and Colorado Transportation Group in Denver, as well as such activities as contract ground handling and Convair 580 maintenance and pilot training. Recently, Frontier Services successfully competed for a contract to train Saudi Arabian pilots on the 737.

Frontier Development Group acquired Russell's, a small but growing catalog sales company. Catalogs are distributed on our planes.

Frontier Holdings recently formed a new subsidiary, Frontier Leaseco Inc., an asset-management unit that will sell and lease used aircraft, ground equipment and related facilities.

Roy Rawls has returned to Frontier to administer Leaseco and coordinate financial planning for all the non-airline subsidiaries, as well as head the Frontier Development Group. Rawls' new title is vice president, financial planning and development, for Frontier Holdings.

None of the activities involving our other subsidiaries are intended to diminish the importance of the airline as the underlying strength of the corporation. In fact, of the $181 million we spent in 1982 on new capital projects, 98 percent (or $178 million) went to the airline, principally to buy new airplanes. Although the contributions of our non-airline subsidiaries are modest, we believe their activities will clearly broaden the scope of the company in future years.

From another perspective, the various subsidiaries of Frontier Holdings offer some employment opportunities for furloughed employees of the airline. Frontier Services, for example, invites furloughed employees to apply for positions with one of its companies.

Financials

Frontier has one of the strongest balance sheets in the industry, and we intend to keep it that way.

On March 11, Frontier Holdings filed a prospectus with the Securities and Exchange Commission registering 1.5 million shares of common stock for sale. Proceeds of this sale would be used to reduce our outstanding bank debts, thereby strengthening our balance sheet. How quickly we begin selling the stock depends on the market price of our stock. At the moment, we are holding off the sale until the stock strengthens.

Our long term debt increased in 1982, mainly because we bought nine new airplanes. We have sizable capacity to borrow more money from banks which we haven't used, mainly because it would further shift our debt to equity ratio in the wrong direction — with too much debt for the amount of shareholders' equity in the company. Selling the additional shares of stock will enable us to shift the debt to equity ratio in a positive direction, and improve the balance sheet.

Shareholders have approved increasing the total authorized capital stock to 35 million shares: 25 million of common stock and 10 million of preferred. This will assure the company has available sufficient shares to maintain a flexible capital structure, although there are no plans to issue the newly approved shares.

Second hub

We constantly look at the possibility of creating a second hub. It is not on the front burner for an instant decision, but we continually evaluate it.

Currently we are a single hub airline, and if for some reason (such as weather) that hub shuts down, then essentially the entire airline shuts down. Because these situations happen only a few times a year we have decided not to go to the effort and expense of developing a "bypass Denver" plan in case of bad weather. The biggest problem is that on any given plane, there are passengers bound for many destinations, all planning to connect in Denver. So it generally doesn't help us to bypass Denver

The future

In the short run, we are anticipating a strong summer, and we hope the yields continue to improve. That is barring an unforeseen return to unrealistic pricing policies by some of the weaker airlines.

We will continue to pursue methods to reduce our operating cost baseline — by limiting labor cost increases without accompanying productivity gains, applying rigid payback analysis to capital investment and utilizing innovative financial management techniques.

While we expect 1983 to continue to present us serious challenges we remain committed to protecting and enhancing the value of our shareholders' investment. With real confidence in the skill and motivation of our employee and management team, we're going to emerge from this difficult period strong enough to resume our positive course.

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